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No. 86-1054

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ASPHALT PRODUCTS CO., INC.,
Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

SUPPLEMENTAL BRIEF

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SUPPLEMENTAL QUESTIONS PRESENTED[1]

1. Whether a taxpayer's stipulation at trial that certain items are nondeductible gives rise to a presumption of the taxpayer's negligence under I.R.C. §6653(a) in claiming these deductions?

2. If a taxpayer's stipulation of nondeductibility at trial creates a presumption of negligence under I.R.C. §6653(a), may the taxpayer overcome the presumption by producing evidence of a reasonable basis for the claimed deduction?

3. Based on the evidence produced at trial in the present case can the finding of negligence under I.R.C. §6653(a) be upheld as a matter of law?

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[1] Petitioner originally attempted to present these supplemental questions for review in a Cross Petition for a Writ of Certiorari, after Petitioner became aware of the filing of a Petition for a Writ of Certiorari by the Commissioner of Internal Revenue requesting review of questions. The Clerk for the Court advised Petitioner's counsel that these questions should be raised, not in a Cross Petition, but in a Supplemental Brief to Petitioner's original Petition for a Writ of Certiorari.

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SUPPLEMENTAL BRIEF

SUPPLEMENTAL OPINIONS BELOW

Additional relevant portions of the opinion of the Tax Court, reported at *47 T.C.M. 1621-39*, are set forth in the Appendix at 1a-5a.

SUPPLEMENTAL GROUNDS FOR JURISDICTION

This Supplemental Brief on Petition for a Writ of Certiorari is being filed in accordance with United States Supreme Court Rule 22.6. The intervening matter not available at the filing of the original

Petition is the filing of a Petition for a Writ of Certiorari by the Commissioner of Internal Revenue.

SUPPLEMENTAL STATUTES INVOLVED

Section 6653 of the Internal Revenue Code of 1954 ("I.R.C.") as amended, 26 U.S.C., in effect for the tax year in question, is relevant to the issue presented in this Supplemental Brief and is set forth in the Appendix at 6a.

SUPPLEMENTAL STATEMENT OF THE CASE

On appeal, the Sixth Circuit unanimously reversed the Tax Court with respect to the negligence penalty. The court of appeals held that on the facts presented the negligence penalty should apply only to the portion of the tax that was due to the company's claimed deduction of items found to be nondeductible personal expenses.

The items in question were expenses incurred in the transportation of two trucks and two pieces of waste water treatment equipment (the "equipment") from the the west coast to Nashville, Tennessee, the Petitioner's principal place of business. At trial, the testimony revealed that the company had purchased two large Kenworth trucks for use in its business and that the trucks needed to be transported from the factory on the west coast. The expenses in question derived from the cost of drivers, gasoline, and other expenses associated with transporting the trucks to Nashville, Tennessee. At the same time as the trucks were to be delivered at the company's expense to Nashville, the shareholders of the company had purchased two large pieces of waste water treatment equipment which also had to be transported from the

west coast to Nashville, Tennessee. When the company dispatched its drivers to pick up the trucks, the drivers also picked up the equipment and transported it back to Nashville with the trucks.

At trial, counsel for Petitioner stipulated that the expenses relating to transporting the trucks and the equipment from the west coast to Nashville were nondeductible. The taxpayer never stipulated that its claimed deduction of these items constituted negligence.

SUPPLEMENTAL ARGUMENT

The Commissioner's Petition for a Writ of Certiorari challenges the Sixth Circuit's reduction of the negligence penalty under §6653(a)[2]. In this situation, Petitioner believes it is appropriate that this Court consider whether the finding of negligence by the Tax Court and affirmed by the Sixth Circuit can be supported as a matter of law.

The Tax Court applied a *per se* rule. In its view, taxpayer's trial stipulation of nondeductibility required a holding that the original claim for deduction was negligent.

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[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

THE FINDING OF NEGLIGENCE IN THIS CASE IS CLEARLY CONTRARY TO THE EVIDENCE AND RESULTS FROM AN IMPROPER AND INCONSISTENT APPLICATION OF THE LAW BY THE COURTS BELOW.

A. The Tax Court improperly imposed negligence *per se* on the taxpayer forclaiming deductions which the taxpayer stipulated at trial were nondeductible.

The Tax Court held that the taxpayer did not establish that the deductions claimed with respect to the transportation of the trucks and equipment were other than a personal expense of the shareholders. Citing *Finney v. Commissioner*, 39 T.C.M. 938, T.C. Memo. 1980-23, the Tax Court held that Asphalt Products' deduction of personal expenditures as business expenses was negligence under §6653(a). However, the court in *Finney* properly looked to "all the circumstances of the instant case" in reaching its decision to impose a negligence penalty. *Id.* at 954. In *Finney*, the court found that 80% of the corporation's travel and entertainment expenses were actually constructive dividends incurred for the personal benefit of the shareholders. These included corporate expenditures related to maintaining a houseboat for which no business purpose was readily apparent. Furthermore, the court found that the corporation failed to maintain accurate records reflecting its entertainment expenditures. These facts all contributed to the court's finding of negligence. In contrast, the Tax Court in the present case applied a *per se* rule that if a corporate expense is determined to be a constructive dividend, then the claimed corporate deduction is negligence and warrants the imposition of the negligence penalty under §6653(a). Such a *per se* rule is not supported by the statute or the case law.

Rather, the cases including *Finney* indicate that the determination of negligence is to be based on all the facts and circumstances presented.

Though a taxpayer's claimed deduction may be disallowed as a matter of law, that fact standing alone will not justify the imposition of the negligence penalty prescribed by §6653(a). Rather, the Commissioner may impose the negligence penalty only where all the facts and circumstances evidence "negligence or intentional disregard of rules and regulations." I.R.C. §6653(a). For example, in *DeFelice v. Commissioner*, 25 T.C.M. 835 (1966), the taxpayer had claimed a bad debt deduction which the Commissioner disallowed primarily on the grounds that the account did not become worthless during the year in question. The Tax Court found no proof that the account became worthless during the year in question and disallowed the deduction. However, the negligence penalty was denied even though the deduction was not allowable as a matter of law. Similarly, in *Oleander Co., Inc. v. United States*, 82-1 U.S.T.C. ¶9395 (E.D.N.C. 1981), the corporate taxpayer claimed deductions for expenses in maintaining a hunting lodge, European travel trips, school tuition, country club dues, and other personal expenses. Although the court disallowed the expenses as a matter of law and held they were constructive dividends to the president/shareholder, the court found no negligence on the corporation's part in claiming those items and refused to impose the negligence penalty.

These prior cases indicate that the Tax Court has uniformly applied an "all the facts and circumstances" test in determining the application of §6653(a). The only evidence introduced at trial on the question of

the deduction of the claimed expenses showed a reasonable basis for the allowance of these deductions. An examination of this evidence reveals that the Tax Court in the present case failed to use the proper standard in applying §6653(a).

B. The finding of negligence is clearly contrary to the evidence introduced at trial.

The Tax Court in the present case failed to properly consider all the facts and circumstances indicated by the evidence presented at trial. Testimony at trial revealed that the corporation had purchased two large Kenworth trucks for use in its business, and that the trucks would have to be transported from the west coast. The expenses in question derive from the cost of drivers, gasoline, and other expenses associated with transporting the trucks from the west coast to Nashville, Tennessee. At the same time as the trucks were to be delivered at the corporation's expense to Nashville, the shareholders had purchased two large pieces of waste water treatment equipment mounted on two large trailers of the type normally pulled by trucks such as the ones that the corporation had purchased. Both the trucks purchased by the corporation and the equipment and trailers purchased by the shareholders required transportation from the west coast. Therefore, the drivers who were bringing the corporation's trucks to Nashville attached the trailers with the waste water treatment equipment to the trucks and transported both the trucks and the equipment to Nashville at the same time.

The following testimony of William B. Akers, a principal shareholder and officer of Asphalt Products, is the only evidence introduced at trial by either side on the issue of the taxpayers' negligence in claiming

deductions for the expenses incurred in transporting the corporation's trucks and the shareholder's equipment across the country.

> We were buying Kenworth trucks at that time, two big tractors with fifth wheel plates on them. Kenworths are made in, wherever it is, Seattle, Washington. All this happened at about the same time. The trailers were available to be moved in California, they needed to get them off the lot, we had purchased them, Kenworth had two trucks ready for us that Lester Turner at Kenworth would be bringing across the country. We said, look, the trucks are on the west coast, the trailers are on the west coast, just drop down and pick them up and come across. That's how Asphalt Products' trucks brought those trailers in and the trailers belonged to us. We didn't see that that was any great expense to Asphalt Products. The trucks were coming across anyway. They picked them up. I think we did license them out there rather than have Lester bring them in under a dealership so that Asphalt Products took possession at the factory, drove them in here, hooked those trailers on. So the mileage was practically the same for the trucks and that's how they came in. As I recall, I made all those arrangements because Lester was selling us the trucks. He may have made them, but that was what happened. We did not send a truck to California to bring those trailers back here.

Trial Court Transcript at 79-80.

The shareholders of the corporation received an incidental benefit by the corporation's payment of the cost incurred in transporting the trucks and the equipment across the country. However, the expense of transporting the trucks across the country would have been incurred by the corporation in any event. A finding of negligence or intentional disregard of rules and regulations cannot be supported on the basis of the evidence presented. Negligence involves a failure to conduct one's affairs as the reasonable man would. It is reasonable for a corporation to deduct the costs incurred in transporting 2 trucks for use in its business even though the expenses incurred also provided an incidental benefit to the shareholders.

C. The taxpayer's stipulation of nondeductibility should not create a presumption of negligence.

The Tax Court based its finding of negligence on the stipulation by Asphalt Products that the deductions claimed for the expenses of transporting the trucks and equipment were not allowable. Asphalt Products does not contend that the expenses claimed are deductible, as the taxpayer is bound by its stipulation on this issue; however, a stipulation as to nondeductibility should not automatically result in a finding of negligence in claiming these deductions.

If the Tax Court's finding of negligence, affirmed without discussion by the Sixth Circuit, is allowed to stand, taxpayers will be discouraged from entering into stipulations as to the disallowance of certain items in many cases. Such a result will undoubtedly lead to longer trials of disputes between the Commissioner and taxpayers and will further burden the federal court system. Taxpayers will be forced to litigate even insignificant adjustments or face application of the

negligence penalty. The only evidence at trial in the instant case clearly showed a reasonable basis for claiming the deduction of these expenses which benefited the corporation and provided an incidental benefit to the shareholders.

CONCLUSION

For the foregoing reasons, the Petition should be granted and a Writ of Certiorari be issued to review the decision below.

Dated: March 1987.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES TAX COURT

T. C. Memo. 1984-208

J. CLARK AKERS, III AND ELEANOR M. AKERS, et al.,[1]
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 6717-77, 5873-80, 6729-77, 5874-80, 6734-78, 5875-80, 6758-78, 5876-80, 6759-78,

Filed April 24, 1984.

* * * *

Mark H. Westlake and *Ervin M. Entrekin,* for the petitioners.

John L. Hopkins and *Robert B. Nadler,* for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

IRWIN, *Judge:* In these consolidated cases, respondent determined deficiencies in petitioners' Federal income taxes and additions to tax as follows:

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[1] Cases of the following petitioners are consolidated herewith: William B. Akers and Jo Ann Akers, docket Nos. 6729-77, 6759-78, 5876-80; Estate of James C. Akers, Estelle L. Akers, Executrix and Estelle L. Akers, docket No. 5874-80; and Asphalt Products Company, Inc., docket Nos. 6758-78 and 5873-80.

Docket Nos.	Petitioners	Year	Income Tax Deficiency	Addition to Tax Sec. 6653(a)[2]
6758-78	Asphalt Products Company, Inc.	1974	154,332.16	$7,716.61
		1975	7,151.98	357.60

After concessions by petitioners and respondent,[3] the issues remaining for our decision are:

* * * *

(2) whether Asphalt Products Company, Inc. properly reported income using the cash basis method, or whether it must use the accrual method of accounting;

* * * *

FINDINGS OF FACT—GENERAL

Some of the facts have been stipulated. The written and oral stipulations, together with the attached exhibits, are incorporated herein by this reference.

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[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue and all references to Rules are to the Tax Court Rules of Practice and Procedure.

[3] For the taxable year 1974, with respect to the notice of deficiency dated March 23, 1978, Asphalt Products Company, Inc. concedes adjustment (f) in the amount of $1,103.04. With respect to the statutory notice for 1976 dated January 25, 1980, Asphalt Products company, Inc., concedes adjustment (f) in the amount of $298.50 and adjustment (g) in the amount of $213.49. With respect to these statutory notices, respondent and Asphalt Products Company, Inc. have agreed to compromise the adjustment marked as adjustment (b) with respect to travel and entertainment expenses for the years 1974 through 1976 as follows: 1974, $7,065.38; 1975, $6,293.27; 1976, $5,096.58.

* * * *

* * * *

Petitioner Asphalt Products Company, Inc. (hereinafter referred to as Asphalt Products) is a corporation with a principal place of business in Nashville, Tennessee at the time its petitions were filed. Its corporate Federal income tax returns for the calendar years 1974 through 1976 and an amended return for 1976 were filed with the Memphis Service Center, Memphis, Tennessee.

* * * *

For organizational purposes, we have found facts separately for some issues in these consolidated cases. However, as certain facts are relevant to more than one issue, the may be used as a basis for resolution of more than one issue.

FINDINGS OF FACT—SPECIFIC

* * * *

Opinion

* * * *

V. Issue 8—Section 6653(a) Negligence Additions

In his notice of deficiency, respondent determined additions to tax under section 6653(a) against petitioner Asphalt Products for the taxable years 1974 and 1975. On reply brief, respondent conceded that petitioner was not liable for the additions to tax for 1975 in the amount of $357.60.

Section 6653(a) provides for an addition to tax if "any part of any underpayment * * * of any [income] tax * * * is due to negligence or intentional disregard of rules or regulations." Petitioners bear the burden of proving that the additions to tax do not apply. *Luman v. Commissioner*, 79 T.C. 846, 860-861 (1982); *Bixby v. Commissioner*, 58 T.C. 757, 791 (1972); Rule 142(a).

Respondent alleges that petitioner was negligent by accounting for its income on the cash method and because it deducted $1,103.04 in expenditures in connection with transporting two wastewater treatment plants from California to Nashville, Tennessee.[25] Petitioner denies negligence with respect to its method of accounting and asserts that its deductions with respect to the wastewater plant transportation were reasonable and do not indicate negligence.

Petitioner has shown good faith reliance on the advice of its accountant with respect to the choice of accounting method. Asphalt Products has shown that the advice of its accountant was based on all the facts and it is not liable for additions to tax on this account. *Conlorez Corp. v. Commissioner*, 51 T.C. 467 (1968); *Woodbury v. Commissioner*, 49 T.C. 180 (1967); See *Leonhart v. Commissioner*, 414 F.2d 749 (4th Cir. 1969), affg. a Memorandum Opinion of this Court. Petitioner has not established, however, that the expense of $1,103.04 with respect to the transportation of the plants was other than a personal expense of William and Clark and thus it is liable for the section 6653(a) addition to tax as a result of this adjust-

[25] As stated in footnote 3, *supra*, petitioner conceded that this amount, representing truckdriver salary of $399.51 and expense reimbursement of $703.53 was not properly deductible. Although on brief, petitioner states that this amount is, after all, properly deductible, justice does not require us to consider the stipulation to be without binding effect. See Rule 91(e).

ment.[26]

Due to concessions,

Decisions will be entered under Rule 155.

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[26] We have held that the deduction by a corporation of personal expenditures as business expenses is clearly negligence. *Finney v. Commissioner*, T.C. Memo. 1980-23.

Asphalt Products has stipulated to the nondeductibility of $1,103.04 in connection with the transportation of the plants from California to Tennessee. To the extent petitioners William and Clark in Docket Nos. 6759-78 and 6734-78, respectively, still maintain they are not taxable on the benefit received by them from their corporation, we find that they have each received constructive dividends in the amount of $551.52 as determined by respondent. See Rule 142(a).

APPENDIX B

I.R.C. §6653 provides:

(a) Negligence or Intentional Disregard of Rules and Regulations With Respect to Income, Gift or Windfall Profit Taxes.

If any part of any underpayment (as defined in subsection (c)(1) of any tax imposed by subtitle A, by chapter 12 of subtitle B or by chapter 45 (relating to windfall profit tax) is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

* * * * * *

(c) Definition of Underpayment-For purposes of this section, the term "underpayment" means-

(1) Income, Estate, Gift, and Certain Excise Taxes—In the case of a tax to which section 6211 (relating to income, estate, gift and certain excise taxes) is applicable, a deficiency as defined in that section (except that, for this purpose, the tax shown on a return referred to in section 6211(a)(1)(A) shall be taken into account only if such return was filed on or before the last day prescribed for the filing of such return, determined with regard to any extension of time for such filing).